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IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

THE CITY OF NEW YORK,

Petitioner,

vs.

SMOSS ENTERPRISES CORP.,

Respondent.

BRIEF FOR RESPONDENT IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

HAROLD S. BERZOW
Counsel for Respondent
Office and P.O. Address
FINKEL, GOLDSTEIN & BERZOW
67 Wall Street
New York, New York 10005
(212) 344-2929

Of Counsel
KEVIN J. NASH

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This brief is submitted on behalf of respondent Smoss Enterprises Corp. (hereinafter "the debtor") in opposition to the petition of the City of New York (hereinafter "the City") for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit from an

order entered in the above proceedings on March 31, 1986.

COUNTER-STATEMENT OF QUESTIONS PRESENTED FOR REVIEW

Whether the tax exemption as provided by §1146(c) of the Bankruptcy Code (11 U.S.C.§1146(c)) applies to the sale of real property by a Chapter 11 debtor-in-possession, which sale is absolutely essential to consummation of the debtor's plan of reorganization, although the sale itself precedes actual confirmation of the plan of reorganization?

COUNTER-STATEMENT OF THE CASE

A. INTRODUCTION

By the instant petition, the City seeks further Appellate review of the principles laid down by the United States Court of Appeals in In re Jacoby-Bender, Inc., 758 F.2d 840 (2d Cir. 1985), as

affirmed in the case at bar, concerning the proper construction and applicability of §1146(c) of the Bankruptcy Code.

The courts below were unanimous in their view that the tax exemptions granted by §1146(c) of the Bankruptcy Code are applicable to transfers of property which form the foundation of a Chapter 11 plan of reorganization, or as noted by the Bankruptcy Court constitute the "keystone of the debtor's plan", regardless of whether the transfer is actually effectuated under a confirmed plan of reorganization, or precedes same. The critical point of inquiry as interpreted by the lower courts involves the relationship between the transfer of property and the debtor's plan of reorganization, and where the two events are inextricably intertwined, the tax exemption applies. This analysis not

only underscores an appreciation of the mechanics involved in a reorganization case, but serves to reinforce the rehabilitative goals which prompted tax relief under §1146(c) ab initio.

Given the relationship described above, the debtor believes certain facts concerning its reorganization efforts deserve mention in order to crystallize the significance of the debtor's sale of real property in terms of its ability to formulate and confirm a plan of reorganization. The pertinent facts bearing upon this relationship are discussed below.

B. BANKRUPTCY PROCEEDINGS

The debtor filed for relief under Chapter 11 of Title 11 of the United States Code (11 U.S.C.§301 et. seq.) ("the Code") on April 30, 1984 and thereafter continued in possession and

management of its property as a debtor-in-possession pursuant to §§1107 and 1108 of the Code. At the time of the Chapter 11 filing, the debtor owned as its sole asset, a 178 unit garden apartment complex located in Queens, New York ("the real property").

This real property was encumbered by three separate mortgages which were in default and subject to state foreclosure proceedings prior to bankruptcy. While the foreclosure proceedings were pending, the debtor, in an effort to salvage its equity in the real property, entered into a written agreement with one Michael Savino dated January 5, 1984 ("the Savino contract"). The Savino contract provided for a sale of the real property at an aggregate purchase price of $2,365,000.00.

Prior to a closing with Savino, the debtor filed its petition under Chapter

11 effectuating a stay of all pending state court foreclosure proceedings pursuant to §362 of the Code. The bankruptcy filing also afforded the debtor additional time to reassess its position vis a vis the Savino contract and to explore alternate sources of financing which might be used to satisfy the claims of creditors.

While operating as a debtor-in-possession, the debtor was approached by a religious congregation ("the congregation") which expressed an interest in funding a plan of reorganization through a financing arrangement. Under the terms of the proposed financing agreement, the congregation would acquire ninety (90%) percent of the debtor's stock interest in consideration for its commitment to post a fund of $2,800,000.00 which would be used to pay creditors. Implementation

of the financing agreement, however, necessitated that the debtor reject the Savino contract pursuant to §365 of the Code upon the grounds that same represented a burdensome executory agreement and was not in the best interests of the estate.

Protracted litigation ensued in the Bankruptcy Court concerning the debtor's motion to reject the Savino contract. The issues before the Bankruptcy Court were complicated by the fact that Savino, as a contract vendee, was entitled to assert a claim for compensatory damages pursuant to §502(g) of the Code by reason of the rejection equal to the difference between the market value of the real property and the contract price. Since the value of the real property had appreciated significantly, Savino's potential damage claim loomed large in terms of formulating a plan of

reorganization, and ultimately made the financing agreement unattractive. Exacerbating matters was the fact that the congregation experienced financial difficulties and there was growing doubt as to its wherewithal to fund an eventual plan of reorganization.

Fortunately, however, the debtor was able to procure still another party who was interested in acquiring the real property, while capable of satisfying all related damage claims. Ultimately, the debtor entered into an agreement with an entity known as G&I Properties, Inc. ("G&I") wherein G&I acquired the real property via an assignment of the Savino contract for a cash consideration of $500,000.00. G&I also agreed to modify the Savino contract so as to increase the purchase price thereunder from $2,365,000.00 to $2,800,000.00. This arrangement eliminated Savino's residual

damage claim, and established a fund of $2,800,000.00 earmarked for the payment of claims, paving the way for a successful reorganization.

The debtor's agreement with G&I was approved by the Bankruptcy Court by order dated March 13, 1985. Shortly thereafter the debtor filed a liquidating plan of reorganization which was confirmed by the Bankruptcy Court on September 11, 1985.

The debtor's plan provided an excellent return to general creditors, as well as full payment to secured and priority claims. It is undisputed, even by the City, that absent a sale of the real property to G&I, the debtor would not have been in a position to propose a plan of reorganization, let alone confirm one. As such, the sale constituted the

lynchpin of the debtor's rehabilative efforts.

C. THE TAX EXEXMPTION UNDER §1146(c) OF THE CODE

After gaining Bankruptcy Court approval to sell the real property, the debtor moved by order to show cause dated April 2, 1985 seeking the following relief: (1) an order declaring that the sale of the real property to G&I was exempt from the collection and payment of local transfer taxes (New York City Real Estate Transfer Tax, N.Y.C. Admin. Code §II46-50) and New York State Real Estate Transfer Tax, N.Y. Tax Law §1402 (McKinney Supp. 1985-1986)) by reason of §1146(c) of the Code; and (2) an order directing that the City Register, Queens County accept the debtor's deed for recording without payment of the aforementioned taxes.

Significantly, the State of New York recognized the applicability of §1146(c) to the transaction and did not object to the proposed tax exemption. The City, however, objected to the debtor's motion upon the principal ground that the sale was made pursuant to a pre-confirmation contract of sale and therefore was not made under "a confirmed plan" within the meaning of §1146(c) of the Code. The City also questioned the applicability of the tax exemption to liquidating plans of reorganization.

The Bankruptcy Court summarily dismissed all of the City's objections noting that the case fell "squarely within the law as laid down by the Second Circuit" in Jacoby-Bender. (App., p.13a). The Bankruptcy Court further concluded that while the transfer was made pursuant to a pre-confirmation contract of sale, the exemption should

nevertheless apply since "whatever its providence" the transfer was "the keystone of the debtor's plan" and "[e]xactly as in Jacoby-Bender 'the plan's consummation depend[s] almost entirely on the sale of the building'". (App. p. 13a).

The decision and order of the Bankruptcy Court was affirmed by the United States District Court for the Eastern District of New York, as per Judge Eugene H. Nickersen, who also commented about the symbiotic relationship between the sale of the debtor's plan of reorganization, stating in pertinent part:

> The language of §1146(c) exempting the transfer by the Bankruptcy Court was surely designed to reach the one transfer on which the plan hinged and which the Court had to approve prior to confirmation." (App., p.8a).

The Circuit Court affirmed the rulings of both lower courts based upon its previous holding in Jacoby-Bender, supra. Since it was uncontroverted that the success of the debtor's reorganization plan was dependent upon the transfer of its real property, the Circuit Court affirmed Judge Nickersen and allowed the debtor to take advantage of the tax exemption under §1146(c) of the Code. (App., p. 1a-3a).

REASONS FOR DENYING THE WRIT

The City's petition for a writ of certiorari must fail for lack of substantiality, both in terms of the question of law presented for review and the absence of any conflict among the Circuit Courts on this issue. See, Sup. Ct. R. 17(1)(a) and (c).

Indeed, the issues before the Court involve narrow points of bankruptcy law,

as evidenced by the lack of prior precedent and the dearth of legislative history, which have little significance outside the scope of this case, given the relative infrequency of single asset reorganization cases involving exclusively real property. Moreover, the Circuit Court's previous opinion in Jacoby-Bender supra, as reaffirmed here, has not been challenged, distinguished, or disavowed by any federal court in the nation and represents a practical construction of §1146(c) of the Code which gives full effect to the ameliorative purposes underlying Chapter 11 rehabilitation.

1

THE CIRCUIT COURT PROPERLY HELD THAT THE DEBTOR'S TRANSFER WAS EXEMPT UNDER §1146(c) OF THE CODE

The City's objection to the lower court's decisions is based upon the

following elements: (1) an overly rigid reading of §1146(c) which does not comport with the rehabilitative aims of Chapter 11; and (2) a glaring mischaracterization of the transfer in terms of the viability of the debtor's plan of reorganization.

Throughout its petition, the City appears fond of mischaracterizing the debtor's transfer to G&I as a mere "preparatory step" to confirmation, when in fact it is obvious that the debtor's plan was entirely dependent upon the sale. The City's failure to reconcile these two event renders its argument inconsequential, if not frivolous, which abrogates the need for further review.

Section 1146(c) of the Code provides as follows:

> "The issuance, transfer, or exchange of a security, or the making or delivery of an instrument of transfer under a plan confirmed under Section 1129 of this title, may not be taxed under any State or local law imposing a stamp tax or similar tax."

In Jacoby-Bender supra, the City pressed an overly semantic argument seeking to limit the tax exemption to only those cases where the debtor's plan of reorganization made specific reference to the proposed transfer.

The Circuit Court, however, found such an argument unavailing as it ignored the realities of a reorganization case. Instead the Circuit Court gave a practical construction to the term "under a plan" within the meaning of §1146(c) so as to include transfers which as a factual matter provide the financial basis for confirming a plan. These

sentiments were expressed in the following passages:

> "Here, as the Bankruptcy Court found, 'the plan's consummation depended almost entirely upon the sale of the building,' the sale in turn depending upon the delivery of the deed. That the plan did not empower the debtor to make a specific sale or deliver a specific deed is irrelevant to our determination that the delivery of the deed took place 'under' the plan within the meaning of §1146(c)." Jacoby-Bender at 841.

The Circuit Court continued at p.842:

> "The City urges that a transfer instrument is not 'dealt with' under a plan unless the plan mentions the instrument in so many words. On the contrary, where, as here, a transfer, and hence an instrument of transfer, is necessary to the consummation of a plan, the plan seems implicitly to have 'dealt with' the transfer instrument."

The principles set forth in the Jacoby-Bender decision were followed and

reaffirmed in the case at bar. Inasmuch as the debtor's plan here was also dependent upon the sale of its real property, the exemption was deemed to apply. Again this construction of §1146(c) represents a realistic approach to the tax exemption issue.

The City has not demonstrated sufficient reason to upset this result. The fact that the sale here slightly preceded confirmation matters very little in terms of the overall results achieved in the case. Regardless of how the plan was worded, the fact remains that the debtor, owning a single asset, could not consummate a settlement with creditors absent the sale. Very simply, the entire bankruptcy case hinged upon the debtor's ability to market the property at an optimum price. At such, an overly rigid interpretation of §1146(c) would frustrate the spirit of

rehabilitation, a result which the Circuit Court properly guarded against.

II

THE ISSUES PRESENTED HEREIN ARE NOT PERVASIVE SO AS TO WARRANT SUPREME COURT REVIEW

The City for the sake of its own self-interest has exaggerated the importance of the lower court's decisions in terms of maintaining the public fisc. Firstly, the fact that tax relief as exemplified by §1146(c) is available to Chapter 11 debtors is indicative of Congressional efforts to facilitate reorganization even at the expense of public treasuries. An overly technical interpretation of the exemption provision under §1146(c) as urged by the City would undermine these efforts.

Lastly, the lower court's construction of §1146(c) does not invite potential abuse since as noted by the

Bankruptcy Court "[i]f the plan fails of confirmation, it will be time enough for the City to claim the tax which a transfer made under a plan of reorganization escapes." (App., p.13a-14a)

In view of the foregoing, public policy concerns raised by the City are of little moment and do not warrant the grant of certiorari in this case.

CONCLUSION

For the reasons set forth herein, the City's petition for a writ certiorari should be denied.

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Respectfully submitted,

HAROLD S. BERZOW
Counsel for Respondent
Smoss Enterprises Corp.
Office and P.O. Address
FINKEL, GOLDSTEIN & BERZOW
67 Wall Street
New York, New York 10005
(212) 344-2929

Of Counsel
KEVIN J. NASH
FINKEL, GOLDSTEIN & BERZOW
67 Wall Street
New York, New York 10005